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Honorable City Council
Detroit, Michigan

The accompanying report provides our analysis of the 2001-2002 Mayor's Proposed Budget for the City of Detroit.

Overview:

The estimated revenues included in the 2001-2002 Mayor's Proposed Budget consist of Local sources, State sources, and Federal sources of revenues in the following amounts and percentages:

	Estimated Revenues (In Millions)	Percent Of Total
Local sources	\$2,481	73.6%
State sources	573	17.0%
Federal sources	318	9.4%
Total	<u>\$3,372</u>	<u>100.0%</u>

The 2001-2002 Mayor's Proposed Budget of \$3.372 billion is approximately \$588 million, or 21.1%, more than the 2000-2001 Budget of \$2.784 billion. However, if the \$360 million increase attributable to the Sale of Sewerage Revenue Bonds is factored out, the 2001-2002 Mayor's Proposed Budget provides for an increase of \$228 million, or 8.2%. On the revenue side, major components of the net \$588 million increase are:

	Increase/(Decrease) In Millions
Sales of Sewerage Revenue Bonds.....	\$ 360
Supplemental Fees GDRRA.....	38
Internal Fund Vehicles – Loan Component.....	26
Water Sales	22
Net Property Tax Revenue.....	20
Sewage Disposal and Treatment Revenue	20
Wagering Excise Tax (Casinos).....	14
Earnings on Investments.....	13
Project Borrowing – Sewerage.....	10
Other Local Sources – Net.....	33
State Gas and Weight Taxes.....	27
Other State Sources – Net.....	(8)
Occupational Skills Training Grant.....	9
Community Development Block Grant.....	7
Federal Sources – Net.....	(3)
Net Increase in Revenues.....	<u>\$ 588</u>



On the appropriation side, major components of the net \$588 million increase are:

	<u>Increase/(Decrease)</u> <u>In Millions</u>
Capital Purchases Related (primarily related to the Capital program for the Sewage Disposal System, including the wastewater treatment plant and to street resurfacing).....	\$ 426
Salaries and Wages (resulting principally from estimated increases in pay rates and additional positions)	42
Employee Benefits (primarily related to the large increase in hospitalization costs, offset, in part, by the reduction in police and fire pension costs).....	8
Fixed Charges (consisting primarily of debt service payments for Water & Sewerage, and General City).....	39
Professional and Contractual Services (related to various Departments, particularly DPW, ITS, Water & Sewerage Department, and Human Services Department).....	30
Operating services (primarily due to increase in GDRRA's sale-lease back payment and tipping fees, and increases in utility costs).....	27
Other Increases (Decreases) – Net.....	<u>16</u>
Net Increase in Appropriations.....	<u>\$ 588</u>

Most of our analysis focused on budget items having General Fund impact. General Fund appropriations included in the 2001-2002 Mayor's Proposed Budget total \$1.499 billion, or 44.4%, of the City's total 2001-2002 appropriations, and \$86 million, or 6.1%, more than the 2000-2001 Budget amount of \$1.413 billion.

Revenues:

The five largest components of General Fund revenue, in descending order by budgeted amount, are municipal income taxes, State revenue sharing, property taxes, wagering excise taxes (casinos), and utility users excise tax.

Municipal income tax revenue is included in the 2001-2002 Mayor's Proposed Budget at \$384.8 million, or \$9.0 million (2.3%) more than the projected actual amount for 2000-2001, even though resident and nonresident municipal income tax rates will decrease from 2.8% to 2.7% and from 1.4% to 1.35%, respectively, on July 1, 2001. The amount of \$375.8 million projected as actual revenue for 2000-2001, which is \$11.6 million (3%) less than the budgeted amount of \$387.4 million, is realistic and reasonable. However, given the decline in the effective income tax rates, the slowdown and uncertainties of the



economy, and the projection for the current year (2000-2001), we estimate that the \$384.8 million included for municipal income tax revenue in the 2001-2002 Mayor's Proposed Budget, which reflects a \$9 million increase over the current year, is optimistic. A conservative approach would be an amount equal to the current year projection of \$375.8 million.

State revenue sharing budgeted at \$332 million is the most stable of the major General Fund revenues. State law assures the City of \$332 million in State revenue sharing from State fiscal year 1998-1999 to State fiscal year 2005-2006, and an annualized amount for the nine month period ending June 30, 2007, subject only to a proportionate reduction if there is a decrease in State sales tax collections from one State fiscal year to the next.

The 2001-2002 Mayor's Proposed Budget includes \$225.5 million for net property tax revenue, which is an increase of \$20.2 million (9.8%) over the 2000-2001 Budget. This increase is attributable mainly to a \$435 million increase in taxable valuations and the application of a higher collection rate (effectively 91.25% versus 90.0%) in 2001-2002 as compared to 2000-2001. Based on our analysis, two factors, which are likely to have a negative impact on net property tax revenue in 2001-2002, are a lower collection rate than is anticipated in the Mayor's Budget, and legal action related to personal property multipliers, which have the effect of lowering the taxable valuations for personal property. We estimate that a collection rate of 90.5%, instead of the 91.25%, is more realistic in view of actual historical experience (a collection rate ranging from 88.0% to 90.7% over the past ten fiscal years), which would result in about a \$1.8 million revenue shortfall. When coupled with our estimate of the negative impact of the reduced taxable valuations for personal property taxes (about a \$4.0 million reduction in revenue) resulting from the legal action previously mentioned, we estimate that net property tax revenue is overstated by about \$5 to \$7 million.

Utility Users Tax revenue is estimated at \$54.6 million in the 2001-2002 Mayor's Proposed Budget, or the same amount of actual collections projected for 2000-2001. Based principally on the City's collection experience during the current fiscal year and in 1999-2000, we conclude that the \$54.6 million estimate for 2001-2002 is reasonable.

The wagering excise tax revenue is budgeted at \$94.3 million in the 2001-2002 Mayor's Proposed Budget, or \$8.7 million (10.2%) more than the actual revenue projected for 2000-2001. Considering the amount of revenue projected for 2000-2001, which includes only eight months of activity for the Greektown Casino, and the level of wagering activity experienced to date by Detroit's three casinos, the \$94.3 million estimate for 2001-2002 is reasonable.

Appropriations:

The amount budgeted for salaries and wages has increased by \$42.1 million (5.2%) from \$804.0 million in the 2000-2001 Budget to \$846.1 million in the 2001-2002 Mayor's Proposed Budget. This \$42.1 million increase provides for estimated increases in pay rates, funding for the additional 269 budgeted positions, additional overtime, and an adjustment for the latest 312 arbitration settlement. The number of total budgeted positions has increased by 269 positions (1.3%) from the 20,642 positions in the 2000-



2001 Budget to 20,911 positions in the 2001-2002 Mayor's Proposed Budget. The net increase in the number of budgeted positions consists of an additional 108 positions in the Water and Sewerage Department, 38 in the Housing Department, 15 in the Law Department, and 118 positions in a number of other City agencies, offset by a reduction of 10 positions in several City agencies. According to the Budget Department, 2,014 (9.8%) of the 20,642 positions included in the 2000-2001 Budget were unfilled, as of April 1, 2001.

Employee fringe benefits (including pensions) for the entire City increased by \$8.1 million (2.2%) to \$369.5 million in the 2001-2002 Mayor's Proposed Budget from \$361.4 million in the 2000-2001 Budget, even though no amount is appropriated for Uniform Police and Fire pension costs. The 2001-2002 Mayor's Proposed Budget does not contain any funding for the Police and Fire Retirement System, a decrease of \$22.2 million from the 2000-2001 Budget. A report prepared by the System's actuary indicates that excess funding amounted to \$622 million, as of June 30, 2000. Our analysis of fringe benefits suggests that the relatively large increases in many fringe benefits do not appear to be consistent with the size of the changes noted in comparisons of budgets of the past few years. We request that the Budget Department provide additional data, information, and analyses on fringe benefits as the budget review process continues, in order to determine the reasonableness of the amounts appropriated as well as the distribution of the appropriations among the various fringe benefits.

Current Year Projection:

The 2001-2002 Mayor's Proposed Budget assumes no General Fund surplus or deficit for 2000-2001, although the Budget Department currently projects a small surplus (\$271 thousand).

The City Administration has instituted measures such as the following to ensure that the City's General Fund will end with a surplus for the fiscal year ending June 30, 2001:

- Hiring is being limited.
- Nonessential purchases are being deferred.
- Employee overtime will be monitored more closely and limited.
- Collection efforts are being increased for revenues owed to the City.

The City has reported a General Fund surplus for each of the past six years, including a surplus of \$2.3 million for the fiscal year ended June 30, 2000. The City is projected to have \$34.1 million in the Budget Stabilization Revenue Fund ("a rainy day fund") next year. The \$34.1 million is a relatively small amount compared to the City's annual budget for the General Fund. To illustrate, the City had \$76 million in its "rainy day fund" at the end of 1989-1990 and it was totally depleted in less than two years.

Financial Implication of Delay in Issuance of Audited Financial Statements for City and DDOT:

As of April 20, 2001, the City is waiting to receive the opinion of the audit firm that audited the Detroit Department of Transportation's (DDOT) financial statements for the year ended June 30, 2000. Lack of DDOT audited financial statements is delaying the issuance of the City's Comprehensive Annual Financial Report (CAFR) for the year



ended June 30, 2000. This is important so that the City is able to issue bonds. In particular, the Water and Sewerage Department (DWSD) is intending to secure low-cost funding through the State's Revolving Fund. However, if the City is not able to provide the State of Michigan with audited financial statements of the entire City, including DDOT, by April 27, 2001, the DWSD will not be able to obtain such low-cost funding in the City's current fiscal year. In addition, the City's ability to issue any long term debt will be delayed, until such audited financial statements are obtained for the entire City.

Other:

Other items of financial importance and interest related to the 2001-2002 Mayor's Proposed Budget include the following:

1. **Labor Negotiation Implications**
Contracts with the City's labor unions will expire on June 30, 2001. Negotiations for the new contracts could result in costs for salaries, wages, and fringe benefits, which are not funded in the Mayor's Proposed Budget. For example, the most recent 312 arbitration settlement resulted in some unexpected costs.
2. **U.S. Census Implications**
The 2000 U.S. census of Detroit resulted in a decrease of 76,704 (7.5%) in the City's population from 1,027,974 in 1990 to 951,270 people in 2000, which could have a negative impact on some future Federal and State funding (e.g., the Headstart Program, Community Development Block Grant, and the State Gas and Weight Taxes), particularly funding partially dependent on per capita formulas. However, the financial impact on certain revenues, such as the Utility Users Tax, resulting from the City's population falling to less than 1,000,000, was eliminated by State Public Act No. 548 of 1998, which reduced the required population threshold to 750,000 people.
3. **Financing of Internal Service Fund for Vehicle Purchases**
The Mayor's Proposed Budget provides for the establishment of an internal service fund for the purchase and lease of City vehicles. While a large portion (\$26 million) of the initial financing of this fund is identified as other miscellaneous revenue in the Mayor's Proposed Budget, indications are that such financing will take the form of a loan from a major financial institution.
4. **Detroit Resource Management System (DRMS)**
The Mayor's Proposed Budget provides \$33.7 million for DRMS, including \$6.2 million to begin the process of implementing the Human Resources/Payroll module of DRMS with an assessment of the City's current system and \$4.2 million for implementation of the fixed asset module. If the City's past experience with the DRMS project is an indicator, there is a likelihood that actual costs could exceed budgeted amounts for the two new modules unless the implementation costs are based on fixed fee contracts.



5. 36th District Court Funding

Under the Mayor's Proposed Budget, the net tax cost of the 36th District Court increased by \$4.2 million, from \$23.1 million in the 2000-2001 Budget to \$27.3 million. This is due to a decrease in the State's obligation to fund 36th District Court operations, under the State Hold Harmless Fund.

6. Health Department Accreditation

The Mayor's Proposed Budget provides funding for fourteen new positions for the Health Department in the City's effort to secure full accreditation from the State of Michigan Department of Community Health, which requires each local public health agency in Michigan to meet particular standards to obtain accreditation. Such accreditation is critical for securing State funding of the City's public health needs in the future.

7. Demolition of Dangerous and Abandoned Buildings

The Mayor's Proposed Budget provides \$12.5 million for the demolition of abandoned and dangerous buildings, which translates into the removal of about 2,000 buildings.

This report includes various summary charts and schedules which provide an overview of the 2001-2002 Mayor's Proposed Budget of \$3.372 billion, and make comparisons to the 2000-2001 City Budget, which totals \$2.784 billion. The report also includes our analyses and comments related to selected material areas (e.g., revenues, appropriations, and other budgetary aspects of City operations) included in the 2001-2002 Mayor's Proposed Budget.

In addition, we have included charts and schedules which provide a ten-year history of total revenues and expenditures, as well as selected revenues (e.g., municipal income tax revenue) and selected Departmental expenditures (e.g., Police Department) of the General Fund. These charts and schedules, which are included in both the Revenues and Appropriations sections of the report, cover the ten-year period from the fiscal year ended June 30, 1991 through June 30, 2000. They compare actual amounts to the revised budget amounts, as presented in the City's Comprehensive Annual Financial Reports (CAFR), for each of the ten years, including the latest available draft of the CAFR for the year ended June 30, 2000. These charts and schedules show that overall, for each of the past ten fiscal years, the General Fund has incurred budget surpluses on the expenditure side of the ledger (revised budget amounts have exceeded actual expenditures) and deficits on the revenue side (actual revenues have fallen short of revised budget amounts).

Along with my staff, I wish to personally thank the Budget Department and the Finance Department for their assistance in this analysis.

Respectfully submitted,


Joseph L. Harris